

Coverdell Education Savings Accounts are accounts set up for the purpose of paying the education expenses of a child beneficiary. The maximum annual contribution is \$2,000 per child. The earnings are tax free as long as the proceeds are used to pay qualified educational expenses.

Eligibility

- The Coverdell Education Savings Account can be set up for an individual under the age of 18. Contributions can be made by parents or any interested individual, including the student, who meet certain income criteria.
- To be eligible to make the maximum annual contribution, taxpayers who file a joint return must have an adjusted gross income (AGI) under \$190,000 or under \$95,000 for all others. The amount of the contribution is gradually reduced for those with an AGI of \$190,000 to \$220,000 for a joint return and \$95,000 to \$110,000 for all others. Taxpayers with an income above \$220,000 for a joint return and \$110,000 for all others cannot contribute to anyone's Coverdell Education Savings Account.
- Family members can coordinate their contributions. If parents don't qualify, a grandparent can make the contribution. Contributions can be made to both Qualified Tuition Plans (Qualified Savings Plans or Prepaid Tuition Plans) and Coverdell Education Savings Accounts for the same beneficiary in any one year.

Contributions

- Are not tax deductible.
- Must end when the beneficiary reaches age 18.
- The maximum annual aggregate contribution to all accounts for one child beneficiary is \$2,000.

Withdrawals

- Are tax free if used for qualified higher education expenses including tuition, fees, books, supplies, and room and board. The definition of qualified expenses are expanded for special-needs students.
- The beneficiary may be enrolled full-time, half-time, or less than half-time at a college, university, or other postsecondary school. The funds may be used for elementary or secondary school as well as college expenses. They may also be used for tutoring and educational supplies, including computers.
- If funds are not used by the time the beneficiary reaches age 30, the funds must be distributed and the earnings will be taxed at the beneficiary's tax rate plus a 10 percent penalty. (Special needs students are exempt from the age requirement.)
- If one child does not use a Coverdell Education Savings Account, it can be transferred to another child. Also, Coverdell Education Savings Accounts can be rolled into 529 Plans.

Coordination with Other Education Tax Incentives

- You cannot use a tax-free distribution from a Coverdell Education Savings Account for the same education expense that is used for the Hope or Lifetime Learning credit. Similarly, you cannot use the Series EE or Series I bond interest exclusion for the same expense.

Advantages

- Withdrawals are tax free if used to pay qualified education expenses.
- These accounts are flexible investment options and may be opened with a bank, mutual fund, or a brokerage firm.
- It is the only tax-favored education plan that allows you to use funds for precollege expenses.

Disadvantages

- Contributions are limited to \$2,000 a year.
- Assets are held in the child's name, which could limit federal financial aid eligibility.
- The tax-free status of the Coverdell Education Savings Plan is due to expire at the end of 2010.

Needs Analysis Implications

- FM: The Coverdell Education Savings Account is treated as a student resource and taxed at 35 percent.
- IM: The Coverdell Education Savings Account is treated as a parent resource and taxed at 3 to 5 percent.

Best Use for College Savings

The Coverdell Education Savings Account is best used by families who want the flexibility of using the funds for precollege education expenses.